

Bank of England

Prudential Regulation Authority

Solvency II: definition of an insurance holding company

Policy Statement | PS6/22

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1. Overview

1. This Prudential Regulation Authority (PRA) Policy Statement (PS) provides feedback to the responses to Consultation Paper (CP) 17/21 'Solvency II: definition of an insurance holding company'.¹ It also contains the PRA's final rules and policy, as follows:

- amendments to the Glossary Part of the PRA Rulebook (the Glossary) (Appendix 1); and
- updates to Supervisory Statement (SS) 9/15 'Solvency II: group supervision' (Appendix 2).

2. This PS is relevant to insurance firms within the scope of the Group Supervision Part of the PRA Rulebook and to the Society of Lloyd's.

Background

3. In CP17/21 the PRA proposed to:

- amend the definition of insurance holding company in the Glossary; to interpret the term 'mainly' by reference to the proportion of a group's assets, revenues, or capital requirements that are derived from insurance or reinsurance subsidiaries, or ancillary insurance services undertakings (ancillary services undertakings that service the insurance part of the group); and
- clarify the PRA's expectations on the information required from firms in order to distinguish an insurance holding company from a mixed-activity insurance holding company. The PRA proposed to provide this clarification as further guidance in SS9/15.

¹ September 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/september/solvency-ii-definition-of-an-insurance-holding-company>

Summary of responses

4. The PRA received eight responses to CP17/21. Some respondents welcomed the PRA's proposals, while other respondents made a number of observations and requests for further clarification which are addressed in the following chapter.

Changes to draft policy

5. After considering the responses, the PRA has made some minor changes to the draft policy, including:

- delaying implementation of the policy until 12 months after publication (the policy and amendment to the PRA Rulebook will therefore come into effect on Friday 7 July 2023);
- amending the phrase 'choosing the more prudent measure' in paragraph 1A.1 of SS9/15, so that there will be supervisory discretion to determine whether to apply the most appropriate measure between net versus gross assets, or between net versus gross revenues; and
- some other minor amendments to SS9/15 to clarify the original proposals.

6. The PRA does not consider the changes made to the draft PS will have a significantly different impact on firms, including mutuals, in meeting expectations when compared to the cost benefit analysis as was presented in CP17/21.

7. When making rules, the PRA is required to comply with several legal obligations, including considering responses to consultation and publishing an explanation of the PRA's reasons for believing that making the proposed rules is compatible with its objectives and with its duty to have regard to the regulatory principles.² In CP17/21, the PRA set out this explanation in Chapter 3 'The PRA's statutory obligations'.³ The PRA considers these explanations to be relevant after taking into account the consultation responses.

8. On Thursday 7 April 2022, HM Treasury published a letter supplementing its 2021 recommendations letter for the Prudential Regulation Committee (PRC), recommending that the PRC 'have regard' to the Government's energy security

² Section 138J(2)(d) FSMA

³ September 2021: <https://www.bankofengland.co.uk/prudential-regulation/publication/2021/september/solvency-ii-definition-of-an-insurance-holding-company>.

strategy and the important role that the financial system will play in supporting the UK's energy security. The PRA's consultation covered by this PS was published prior to that date, however the PRA has now considered this new have regard. The PRA considers that this new have regard does not affect this policy change. This is because this policy change is related to interpreting and applying the definition of an insurance holding company for the purposes of the Group Supervision Part of the PRA Rulebook and so is not expected to have any relevant implications.

Implementation and next steps

9. The change to the Glossary and the expectations set out in the updated SS9/15 will take effect 12 months after publication of this PS. Consequently, the changes will come into effect on Friday 7 July 2023.

10. References related to the UK's membership of the EU in SS9/15 covered by the policy in this PS have been updated as part of this PS to reflect the UK's withdrawal from the EU. Unless otherwise stated, any remaining references to EU or EU-derived legislation refer to the version of that legislation which forms part of retained EU law.⁴

2. Feedback to responses

11. Before making any proposed rules, the PRA is required by FSMA to have regard to any representations made to it, and to publish an account, in general terms, of those representations and its feedback to them.⁵

12. The PRA has considered the responses received to the CP. This chapter sets out the PRA's feedback to those responses, and its final decisions.

13. The responses have been grouped as follows:

- supervisory discretion;
- trigger event for reclassifying holding companies;

⁴ For further information please see Transitioning to post-exit rules and standards **page: <https://www.bankofengland.co.uk/eu-withdrawal/transitioning-to-post-exit-rules-and-standards>**.

⁵ Sections 138J(3) and 138J(4) of FSMA.

- timing of application of proposed changes;
- implications for UK competitiveness and market innovation;
- definition of ancillary insurance services undertaking;
- revenue measure;
- asset measure;
- capital requirements measure;
- comparing insurance holding companies and mixed-activity insurance holding companies;
- time duration for calculation; and
- consistency between PRA rules and Solvency 2 Regulations 2015.

Supervisory discretion

14. The PRA proposed that supervisory discretion will apply when classifying whether a holding company is an insurance holding company or a mixed-activity insurance holding company in a number of instances (eg in the calculation of assets and revenue measures; and the time period for which the assets, revenue, and capital requirements measures would be calculated). The PRA proposed to apply the more prudent measure when choosing the more appropriate measure between gross versus net assets and gross versus net revenues.

15. Five respondents expressed a strong preference for PRA supervisors to exercise supervisory discretion when classifying a holding company, rather than relying on quantitative measures. Suggestions for a broader list of measures were put forward, including: the level of risk in insurance versus non-insurance components of the business; capital structure; governance; approach to reinsurance; and strategic business plans. One respondent asked for more clarity on what the PRA meant by 'choosing the more prudent measure'.

16. One respondent noted that groups which operate near the boundary of being classified as a mixed-activity insurance holding company will not be able to utilise capital management flexibility easily to build the non-insurance part of the business to achieve mixed-activity insurance holding company classification. This respondent requested the PRA to consider an exemption for groups that are

building a portfolio of non-insurance activities, but do not currently meet the 50% threshold for a mixed-activity insurance holding company classification.

17. As previously noted in CP17/21, the PRA clarifies that supervisory discretion will apply when classifying whether a holding company is an insurance holding company or a mixed-activity insurance holding company in a number of ways, including:

- when considering what should be included in the calculation of assets and revenue measures (eg net versus gross measures), so that these measures best reflect a given firm's circumstances; and
- where there are exceptional conditions or material year-on-year volatility in the assets, revenue, and capital requirements measures, the PRA may take into consideration the average of data over a three-year or five-year reference period, as opposed to the standard one-year reference period for making such assessments.

18. The PRA also clarifies that supervisory discretion will be applied when considering gross versus net measures, to account for a variety of business models. Consequently, the PRA has made a minor modification to the draft policy by amending the phrase 'choosing the more prudent measure' in paragraph 1A.1 of SS9/15, so that there will be supervisory discretion to determine whether to apply the most appropriate measure between net versus gross assets, or between net versus gross revenues. Consequently, the more prudent measure will be considered, but will not be the only factor taken into account.

19. In addition, where the application of the amended definition could be unduly burdensome, or does not achieve its intended purpose, the PRA may exercise its powers to modify the relevant elements of the amended insurance holding company definition, subject to firms meeting the usual statutory tests⁶ at the appropriate point in time. The PRA may consider a waiver or modification in relation to the application of one or more of the three measures (assets, revenue and capital requirements); or the requirement to include ancillary insurance services undertakings in the insurance part of a group. This guidance has been added to SS9/15 in paragraphs 1A.5 and 1A.6.

20. Nevertheless, the PRA considers that the application of a 50% threshold combined with meeting two out of the three measures will be a suitable test in most cases, since it creates certainty for both the PRA and firms' expectations,

while also allowing for a consistent approach across groups for the purposes of assessing holding company classifications. The PRA considers that its resources would not be used in an economically efficient way if a broader range of measures were to be applied as a matter of course.

Trigger event for reclassifying holding companies

21. The PRA proposed that existing holding company classifications would not be revisited, unless a trigger event occurs, or if a firm asks the PRA to reconsider the classification of its holding company.

22. Three respondents requested further clarification on what constitutes a trigger event for the purposes of reviewing holding company classifications. One respondent also expressed concern that the proposed rule changes could restrict access to third party debt financing if a trigger event occurred, which could cause firms to change their business models.

23. The PRA clarifies that 'triggers' will be events involving, but not limited to: acquisitions; disposals or changes in control; whereby the financial measures of assets; revenue; and capital requirements are impacted in such a manner that it changes a holding company's classification from a mixed-activity insurance holding company to an insurance holding company, or vice versa. This clarification has been reflected in paragraph 1A.3 of SS9/15.

Timing of application of proposed changes

24. The PRA proposed that the changes in CP17/21 would only apply to future determinations of whether a holding company is an insurance holding company or a mixed-activity insurance holding company. The PRA proposed that existing holding company classifications would not be revisited, unless a trigger event occurs, or if a firm asks the PRA to reconsider the classification of its holding company.

25. A few respondents welcomed this proposal. One respondent queried why the proposals would only apply to future holding company determinations, and cited that this may result in inconsistency in the supervisory treatment of groups that may otherwise be comparable (eg in areas such as capital management at the group level). Two respondents expressed concern that the proposed definition could force some mixed-activity insurance holding companies to refrain from engaging in strategic decisions (such as acquisitions), for fear of creating a trigger event such that the group's existing classification might change.

26. The PRA confirms that existing holding company classifications will not be revisited unless a trigger event occurs, or if a firm asks the PRA to reconsider the classification of its holding company. The PRA considers that it is important to apply the rule changes consistently. Therefore, as the composition of groups change over time (eg through organic growth, acquisitions, disposals, or any such trigger events), the holding company classification will need to be adjusted as appropriate between mixed-activity holding company and insurance holding company. As noted above, the PRA may apply supervisory discretion and take into consideration the average of data over a three-year or five-year reference period, as opposed to the standard one year. The PRA considers this will mitigate respondents' concerns over a 'cliff edge' scenario arising.

27. The PRA has also revised the implementation date for the policy changes; there will be a 12-month period between publishing this PS and the policy and amendment to the Rulebook coming into effect. This will allow groups that come within the scope of full group supervision as a result of the amended definition to prepare themselves to apply any additional requirements and expectations which might arise from group supervision.

Implications for UK competitiveness and market innovation

28. The PRA proposed that by providing further clarity on the definition of an insurance holding company and distinguishing it from a mixed-activity insurance holding company, the engagement between firms and the PRA could be more efficient, and could reduce regulatory costs for the firm and the PRA. By including ancillary insurance services undertakings in the types of insurance or reinsurance subsidiaries that are referred to in the definition of an insurance holding company, the PRA sought to uphold consistency in its supervisory treatment of comparable holding companies, regardless of how they are structured.

29. One respondent noted that the PRA's proposal could restrict UK innovation and efficiency in two ways:

- trigger events for reclassification to an insurance holding company could prevent UK firms from acquiring insurance businesses, internally restructuring, or entering into new ventures; and

- the EU's proposals for defining an insurance holding company under Solvency II are less prescriptive than those put forward by the PRA, which would, in their view, stifle UK innovation relative to the EU.

30. Another respondent noted that the proposed rule changes could deter new private investment into the UK (eg privately-funded insurtech companies, or managing general agents which have an underwriting component to their business).

31. The PRA considers that to ensure that regulatory requirements are applied consistently between regulated firms, it would not be appropriate to apply a broad range of measures across different groups. This is because it would not result in a consistent assessment as to whether holding companies are insurance holding companies, or mixed-activity insurance holding companies. The PRA considers that consistency in the PRA's supervisory treatment of comparable holding companies would facilitate effective competition.

32. The EU is proposing amendments to its own definition of an insurance holding company. The published draft of the proposed amendments to the Solvency II Directive sets out a threshold of 50% with reference to various measures (including assets and revenues) as well as any other indicator considered relevant by the national supervisory authority.⁷ The PRA considers that changing the definition of an insurance holding company to outline an exhaustive list of measures in the Glossary gives firms more certainty. Chapter 1A of SS9/15 further sets out the PRA's expectations in relation to the rule change including the provision of additional guidance on how supervisory discretion could be applied.

33. Furthermore, the PRA may exercise its powers to waive or modify the relevant elements of the amended insurance holding company definition, subject to firms meeting the usual statutory tests⁸ at the appropriate point in time.

⁷ Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL amending Directive 2009/138/EC as regards proportionality, quality of supervision, reporting, long-term guarantee measures, macro-prudential tools, sustainability risks, group and cross-border supervision, <https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52021PC0581>.

⁸ Section 138A(4) FSMA.

Definition of ancillary insurance services undertaking

34. The PRA proposed to include ancillary insurance services undertakings in the types of insurance or reinsurance subsidiaries that are referred to in the definition of an insurance holding company.

35. Five respondents requested more clarity on the definition of ancillary insurance services undertaking, as they considered the list of undertakings and the activities as mentioned in the definition to be too broad.

36. Having considered the responses, the PRA has decided not to revisit the definition of ancillary insurance services undertaking, as it considers that the current definition rightly captures a range of services undertakings which are possible for insurance groups to set up. The definition is also derived from the definition of 'ancillary services undertaking' in the Glossary, which has wider application beyond insurers. Consequently, keeping the ancillary insurance services undertakings definition similar to the ancillary services undertaking definition will help ensure overall consistency.

Revenue measure

37. The PRA considers that the proportion of a group's revenues derived from insurance or reinsurance subsidiaries, or from ancillary insurance services undertakings, measures the group's reliance on cash flow from insurance activities. As such, the PRA proposed in CP17/21 that revenue should be one of the three measures to be considered when determining whether a holding company is mainly comprised of insurance or reinsurance subsidiaries.

38. Four respondents requested further clarification on the meaning of net revenue, and whether this would capture the effect of reinsurance. One respondent also requested clarification on how the revenue measure could be affected by intra-company transactions.

39. One respondent suggested that the revenue measure should be given more prominence over the asset and capital requirements measures, since the share of a group's revenues from different activities may present a more directly comparable picture of its different activities.

40. The PRA confirms that net revenue refers to revenue after factoring outward reinsurance, and has clarified this in paragraph 1A.1 of SS9/15. The PRA is concerned with the proportion of revenue from insurance subsidiaries, reinsurance subsidiaries and ancillary insurance services undertakings at the legal entity level

and group level, and consequently, intra-company transactions are not considered to be in the scope of 'revenue' for these purposes.

41. The PRA has decided not to place more emphasis on the revenue measure over the asset and capital requirements measures. Various groups could be structured differently depending on their business models, and placing more emphasis on one measure over others would not be appropriate, in the PRA's consideration, to account for these differences.

Asset measure

42. The PRA considers that the proportion of a group's assets derived from insurance or reinsurance subsidiaries, or from ancillary insurance services undertakings, reflects the relative size of insurance business in the group. As such, the PRA proposed in CP17/21 that assets should be one of the three measures to be considered when determining whether a holding company's subsidiaries mainly comprise of insurance or reinsurance subsidiaries.

43. Two respondents noted that mixed-activity insurance holding companies could have limited net assets, since they are not subject to the same regulatory requirements that insurance holding companies are, and as such, groups containing asset-rich insurers could be penalised (eg if they do not pay dividends, as a means of retaining capital). Three respondents noted that the calculation of the group assets, especially if calculated on a Solvency II valuation basis, could undervalue balance sheet assets deployed in non-insurance sectors and as such, could limit the ability to provide a fair view of the weighting of the business mix between insurance and non-insurance.

44. One respondent suggested that operating profit or earnings before interest, taxes, depreciation and amortisation (EBITDA) would be more appropriate measures as compared to the asset measure that was proposed by the PRA in CP17/21.

45. The PRA considers assets to be a relevant measure when determining whether the subsidiaries are mainly insurance, and it is up to groups to determine how to structure their capital. Furthermore, where groups are on the boundary of a mixed-activity holding company classification (or vice versa), the PRA considers that there is enough room in the policy to apply supervisory discretion when choosing the more appropriate measure between gross and net assets.

46. The PRA clarifies that firms will be permitted to present their asset figures using either a Solvency II, IFRS or UK GAAP basis of valuation, as long as insurance and non-insurance entities are valued consistently on the same basis of valuation in order to facilitate better comparisons.

47. The PRA has decided not to use operating profit or EBITDA as indicators, because they may be more volatile (eg operating profit could be zero or negative during particular years), and so will not be as meaningful as the asset measure.

Capital requirements measure

48. The PRA considers that the proportion of group capital requirements (as if calculated at the level of the parent) derived from insurance or reinsurance subsidiaries, or ancillary insurance services undertakings, represents quantifiable risks to the group arising from its insurance business. As such, the PRA proposed in CP17/21 that capital requirements should be one of the three measures to be considered when determining whether a holding company mainly comprises of insurance or reinsurance subsidiaries.

49. One respondent contended that the capital requirements measure could unfairly weigh up the mix of business in a group, because non-regulated firms do not have capital requirements. Three respondents noted that groups that contain non-financial entities are likely to exceed the 50% threshold in most cases because non-financial businesses are not subject to capital requirements.

50. The PRA considers the capital requirement measure appropriate because it is derived from insurance, reinsurance, or ancillary insurance services undertakings, and thus represents quantifiable risks to the group arising from its insurance business. Furthermore, as per Article 336 of the Delegated Regulation,⁹ non-regulated and non-financial undertakings within a group contribute to the consolidated group Solvency Capital Requirement (SCR), even if they are not subject to solo regulatory capital requirements.

⁹ Commission Delegated Regulation (EU) 2015/35 of 10 October 2014 supplementing Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) Text with EEA relevance.

Comparing insurance holding companies and mixed-activity insurance holding companies

51. The PRA proposed that a holding company's subsidiaries would be considered as mainly insurance or reinsurance subsidiaries in cases where at least two of three measures exceed the 50% threshold.

52. Three respondents interpreted this proposal to mean that, in order to become an insurance holding company, 'only' two out of the three measures would have to be more than 50% insurance-related, whereas to become a mixed-activity insurance holding company, all three measures would have to be less than 50% insurance-related. These respondents asserted that there should be parity in the approach taken to the respective definitions.

53. The PRA clarifies that in order for a holding company to be an insurance holding company, two or more of the three measures will need to be above the 50% threshold. As a consequence, a holding company would be a mixed-activity insurance holding company where two out of the three measures are below the 50% threshold.

Time duration for calculation

54. The PRA proposed that, where a firm wishes to demonstrate that a holding company is a mixed-activity insurance holding company, it should provide calculations using the latest full year reference period, or an average of the past three years where there is material year-on-year volatility in figures.

55. One respondent noted that, depending on how the Covid-19 pandemic impacts the travel industry, certain firms may experience issues with the three-year average revenue measure. The PRA considers that a one-year reference period would be the norm. An average of the past three years could be appropriate to account for volatile years. However as noted above, where there were extremely exceptional conditions, including disruptions caused by the Covid-19 pandemic in certain sectors such as travel, a five-year average could be considered at the discretion of the PRA.

Consistency between PRA rules and Solvency 2 Regulations 2015

56. The PRA proposed to include ancillary insurance services undertakings in the types of insurance or reinsurance subsidiaries that are referred to in the definition of an insurance holding company.

57. One respondent opined that this proposal would result in a difference between the respective definitions of insurance holding company in the PRA Rulebook and Solvency 2 Regulations 2015 (the Regulations), since the PRA Rulebook definition would take into account ancillary insurance services undertakings.

58. Whilst the definition of insurance holding company set out in the Regulations does not expressly refer to ancillary insurance services undertakings, the PRA considers that it does not restrict the PRA from taking such undertakings into account for the purposes of the definition which applies in PRA rules. The PRA considers this not to give rise to any conflict between PRA rules and the Regulations.

3. Appendices

- 1 PRA RULEBOOK: GLOSSARY: (SOLVENCY II) AMENDMENT INSTRUMENT, available at: <https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/policy-statement/2022/july/ps622app1.pdf>
- 2 SS9/15 'Solvency II: Group Supervision', available at: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/solvency2-group-supervision-ss>